protected.[22] The court blocked the joint venture on the basis that a nonprofit's assets cannot be commingled with those of a for-profit corporation under Michigan's Nonprofit Corporations Act. However, the court did state that a sale of the assets would be permitted.

In another example, a Missouri state court judge was seemingly lobbied into holding that a nonprofit entity was of a charitable nature. In 1994, the Missouri Department of Insurance ("DOI") approved a transaction whereby Blue Cross and Blue Shield of Missouri ("BCBSMO"), a nonprofit health services corporation, transferred 80 percent of its assets to a for-profit subsidiary. After the insurance commissioner decided that this "reorganization" actually amounted to a conversion, he sought to retain the charitable assets of BCBSMO.

On September 9, 1996, a Missouri judge ruled that BCBSMO had no public benefit obligation arising from its 1994 creation of a for-profit subsidiary.[23] On December 30, 1996, the court reversed itself while ruling on a counterclaim in the same case,[24] holding that BCBSMO had exceeded its authority when it shifted 80 percent of its assets to a for-profit subsidiary. The judge also held that the DOI could amend its approval of the reorganization. The ruling cleared the way for the judge to require BCBSMO to transfer its assets to a charitable entity.

As these examples illustrate, several courts have joined the fight to ensure that the charitable purposes are not lost in the process. For their own protection, CareFirst's directors must carefully consider all aspects of any proposed transaction for possible effects on the public interest or the well-being of policyholders, contractholders, insureds, and other affected groups.

C. Valuation Issues

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[22] *See* Kelley v. Michigan Affiliated Health care System, Inc., No. 96-83848-CZ (Mich. Cir. Ct. Sep. 5, 1996).

[23] Missouri Blues Win Suit Against the State; Court Finds No Public Benefit Obligation, 5 Health L. Rep. (BNA) 1387-88 (Sep. 19, 1996).

[24] *See* Blue Cross and Blue Shield v. Angoff, No. CV 196-619 (Mo. Cir. Ct. Dec. 30, 1996).

Often at the heart of conversion controversies are difficult issues of valuation. In the CareFirst context, relevant statutes support the view that maximizing value is not required. For example, in Maryland, the statute discusses the receipt of the "fair value"[25] of the public or charitable assets. Likewise, in the District of Columbia, the Corporation Counsel may not approve a conversion of a nonprofit unless steps have been taken to safeguard the value of its charitable assets.[26] Significantly, neither statute discusses or implies the need for obtaining the highest price possible but only the "fair value" or safeguarding of the "value" of the charitable assets. This is consistent with the notion that *Revlon* duties do not apply in the context of a possible CareFirst conversion/merger, and therefore factors other than price may be considered by the board. At the same time, directors of nonprofits must ensure that they discharge their duties of care by safeguarding the value of the nonprofit's assets in the transaction so that the organization will continue to satisfy its charitable purposes and that the interests of the community are protected.[27] Accordingly, directors can not be blind to the valuation of the enterprise in the transaction. The CareFirst board of directors will want to rely on a "fairness opinion" from experts at valuing nonprofit health care companies, because the valuation process of a nonprofit is more complex and uncertain than the valuation of a comparably-sized for-profit due to the fact that there is no readily ascertainable market value.

Traditionally in health care transaction three different methods of valuation are used: 1) replacement cost or asset valuation; 2) market comparison, which involves setting the sale price in relation to comparable assets; and 3) the most widely used method, discounted cash flow analysis, which establishes a price by projecting a health provider's earning potential.[28] Some commentators have recommended that legislation

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[25] The Maryland Insurance Administration may consider all relevant factors in determining fair value, including: the value of the nonprofit health entity or an affiliate or the assets of such an entity that is determined as if the entity had voting stock outstanding and 100% of its stock was freely transferable and available for purchase without restriction; the value as a going concern; the market value; the investment or earnings value; the net asset value; and, a control premium, if any. §6.5-301(d).

[26] 32 D.C. Code §553 (1999).

[27] Naomi Ono, *Boards of Directors Under Fire: An Examination of Nonprofit Board Duties in the Health Care Environment,* 7 ANNALS OF HEALTH L. 107, 130 (1998).

[28] Fishman, *supra* note 2, at 719.

require a "market test".[29] Under this approach, any Blue Cross that is up for sale or conversion would be required to offer itself to other bidders beyond the initial offeror once the nonprofit board has reached a decision to sell or convert. The requirement of a market test would entail public disclosure of the proposed transaction, the release of relevant information to responsible persons, an adequate time period for competing offers to be made, and prohibitions on lock ups and other devices which would taint the test.[30]

Under current law, however, there is no absolute duty to maximize financial return in the CareFirst context. Rather, factors other than price may be considered, and the board is not required to accept the highest price if other factors outweigh the financial considerations. Whether or not to recommend acceptance of a particular bidder is within the business judgment of the board. It may be that the higher financial bid will not be the best for the organization as a deliverer of healthcare, the financial situation of the higher bidder may be precarious, or some other factor may dictate that the higher price may not produce the best result for the organization.

While this reasoning is consistent with the conclusion that the Business Judgment Rule, and not the more stringent *Revlon* standards, will govern the CareFirst Board's decision-making process, there is only one court decision that has addressed the issue in the context of the conversion of a health care company. In that case, a Californian nonprofit HMO, Family Health Plan (FHP), applied for conversion. Its board of directors had valued its assets at $13.5 million. The California Department of Corporations rejected the valuation and proposed $47 million as the fair market value. The Department then negotiated a $38.5 million price which included $7.2 million in cash and the rest paid over ten years.[31] Another for-profit HMO made a competing offer to buy FHP for $50 million and sued, along with the California Attorney General, to require FHP to accept the highest bid. At the time both the president of the company giving the competing offer and the FHP's own documents indicated that FHP's fair market value

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29 Fishman, *supra* note 2, at 720 (citing Harvey Goldschmid, *Nonprofit Conversion Transactions: Existing Fiduciary Duties and Necessary Reforms, in* CONVERSION TRANSACTIONS: CHANGING BETWEEN NONPROFIT AND FOR-PROFIT FORM 1 (1996)).

30 *See* Fishman, *supra* note 2, at 719 (citing RONALD GILSON & BERNARD BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 1020-23 (2d ed. 1995)).

31 Fishman, *supra* note 2, at 707.

might have been substantially higher. In an unreported decision, the court permitted the conversion to for-profit status holding that the law did not require sale to the highest bidder.[32]

D. Other Issues

In order to comply with charitable requirements, a converting nonprofit entity may give its charitable assets to an existing charity or it may create a new charitable foundation. In certain transactions, charitable proceeds have been used to support government programs. In some early California HMO conversions, charitable proceeds were used to support the MediCal program. More recently, a majority of the assets from the conversion of Trigon Blue Cross in Virginia were used to support the state's higher education budget. In most cases a new foundation is created. Approximately 60 new foundations were formed for various HMO and Blue Cross Blue Shield conversions between 1990 and 1997, with assets estimated in the $5 billion range.

In the transaction at hand, three of CareFirst's subsidiaries will convert to for-profit status before the business combination, thus necessitating the disposal of their charitable assets. Maryland specifies that the assets of a Maryland insurer will go to the Maryland Health Care Foundation; Delaware and the District of Columbia do not designate a specific charity. Nevertheless, since the purpose is to benefit the public interest of a particular state, and given that previous conversions allocated their charitable proceeds to support in-state causes, it seems likely that the Delaware and D.C. CareFirst subsidiaries will need to give their assets to a new in-state foundation or an existing in-state charity in their respective jurisdictions.

E. Conclusion

In the context of conversion and merger, CareFirst's Board of Directors for its subsidiaries involved in the transactions must act with good faith and in the reasonable belief that their actions are in the best interest of policyholders/contractholders, insureds and the public interest in general. Presumably the Board of Directors of CareFirst itself owes the same duties but not limited to the parties in a specific state. Rather, the

32 *See* Fishman, *supra* note 2, at 707 (citing Maxicare Health Plans v. Gumbiner, No. C-565072 (Los Angeles Superior Court, 1986)).

directors would be required to safeguard the interests of policyholders, insureds and other affected groups in all the relevant states.

The board must insure that the transaction does not involve self-dealing and must be comfortable that the price received, while not necessarily the highest offered, is sufficient to safeguard the value of the insurer's assets for the public. If these standards are met, the board may also consider non-price factors in determining whether to approve a transaction and may take comfort in knowing that their deliberations will be governed by the Business Judgment Rule and not the stricter *Revlon* standards.

Summary of Fiduciary Duties and Statutory Standards
Relating to Possible Business Combinations[33] Of CareFirst

	Common Law Fiduciary Duties	Issues re: fiduciary duties	Statutory Standards for Conversion	Statutory Standards for Acquiring Control
Maryland	• General oversight responsibility. • Duty of care. • Duty of loyalty.	• Directors may rely on experts. • Business judgment rule is generally applicable. • Conflicts of interest are not a disqualifier if disclosed. • Interlocking boards may create conflicting interests.	• Is the transaction in the public interest? • Was appropriate due diligence exercised? • Were all conflicts of interest disclosed? • Was the fair market value for assets received? • Was there an adverse impact on health care services?	• Is the acquirer financially sound? • Is the transaction fair to policy holders? • Is the acquisition in the best interests of policy holders? • Is the acquisition in the Public interest?
District of Columbia	Same[34]	Same	None	Same
Delaware	Same	Same	• Is the transaction fair to contract holders? • Did any assets inure directly or indirectly to any director/officer/ trustee?	Same

33 *See* the accompanying memo for a more complete and accurate picture of the topics laid out herein.

34 The duty of care is not mentioned in the D.C. Statutes, however, given the prevalence of the doctrine and the numerous D.C. cases that have discussed this fiduciary duty, its existence in D.C. can be implied.

EXECUTIVE SUMMARY

Credit Suisse First Boston ("CSFB") is pleased to have the opportunity to present to CareFirst's Strategic Planning Committee ("SPC") our analysis of a strategic combination with either Trigon Healthcare, Inc. ("Trigon") or WellPoint Health Networks Inc. ("WellPoint").

- **The table below is intended to update the SPC on the events that have taken place subsequent to the December 4, 2000 Board of Directors' meeting:**

DATE(S)	ACTIVITY	DESCRIPTION
1/11/01	Meeting in Dallas	Discussion between Bill Jews and Leonard Schaeffer (WellPoint) regarding non-price deal issues
1/04/01	Meeting in Owings Mills	Discussion between senior management of WellPoint and CareFirst
1/03/01	Meeting in Virginia	Discussion between Bill Jews and Tom Snead (Trigon) regarding non-price deal issues
12/27/00–12/28/00	Conference call	Follow-up due diligence requests by Trigon and WellPoint
12/19/00–12/21/00	WellPoint due diligence at CareFirst	Data room and management interviews
12/11/00–12/15/00	Trigon due diligence at CareFirst	Data room and management interviews

KEY TRANSACTION ISSUES

CSFB has attempted to outline the many criteria that can be considered by the Board of Directors when evaluating a potential strategic transaction. Total strategic value encompasses quantifiable and non-quantifiable elements such as those outlined below:

CRITERIA	COMMENTS
STRATEGIC GOALS	
Revenue Growth	• $8-$11 billion in revenues producing 15%-22% annual revenue growth between 1999 and 2003 and serving 4.2-6.1 million members
Market Share	• The top market position in key consumer segments with a diversified portfolio and three times the relative market share of the next competitor in the core service area
Capital	• Minimum capital of $500-$600 million and $1,000-$1,100 million in excess and contingency capital resulting in a total capital base of $1,500-$1,700 million; underwriting margins of 1%-2%
BUSINESS CASE	
Marketability	• Impact of competitors' response to merger
Synergies	• Revenue growth; cost of care savings; administrative cost savings; IT investment savings / avoidance; cost of capital
Earnings Growth	• Incremental growth above "stand-alone" expectations
Benefits to Constituents	• Members; employers; providers; government / residents; employees; brokers / agents
Success of Post-Closing Integration	• Corporate culture; information technology; financial strength of partner

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